CORPORATE DEBTOR'S RIGHT TO FILE A CIRP AND ITS IMPLICATIONS

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INTRODUCTION

India is a developing country dealing with an escalation of entrepreneurs and businesses'. With the increase in their support towards boosting economic growth comes the liability to pay off debts. It is not reasonable to assume that all businesses will flourish, it is normal for some to fail and this creates a demand for an effective corrective action. There are various laws like Sick Industrial Companies (Special Provisions) Act, 1985, the Recovery of Debt Due to Banks and Financial Institutions Act, 1993, the Securitisation and Reconstruction of Financial Assets, Enforcement of Security Interest Act, 2002 and the Companies Act, 2013 which deal with insolvency and bankruptcy procedures. The law relating to corporate insolvency is concerned not with the factual state of the company's finances but with the technical legal state of the company as a legal entity.[1] Each of these legislations extends remedies to resolve the issue of insolvency and bankruptcy in various entities. These provisions over-lapped with each other and often lead to the delaying of insolvency procedure. This delay brought to light the issue of over-riding effect that it creates. With the presence of various overlapping laws dealing with financial failures and insolvency, The Bankruptcy and Insolvency Code, 2016 (herein referred to as IBC) has proven to be a much-needed refurbishment of the existing framework dealing with the insolvency of corporations, partnerships, individuals and various other entities. The Code aims to reorganize and resolve any issues pertaining to insolvency in a time-bound manner and emphasizes on the maximization of the value of the assets of entities concerned. As per data available with the World Bank in 2016, insolvency resolution in India took 4.3

[1] EDWARD BAILEY AND HUGO GROVES, CORPORATE INSOLVENCY LAW AND PRACTICE 3 (LexisNexis 4th ed., 2015).

years on an average[2] which was significantly inefficient. IBC has been defined by the act as an "Act to consolidate and amend the laws relating to reorganisation and Insolvency Resolution of corporate persons, partnership firms and individuals in a time bound manner for maximisation of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues and to establish an Insolvency and Bankruptcy Board of India, and for matters connected therewith or incidental thereto."[3] The Code's main objective lies in bringing all the insolvency procedures under one umbrella which would result in speeding up the process.

On the commission of a default by a corporate debtor, according to Section 6 of the IBC a financial creditor, an operational creditor or the corporate debtor itself can initiate corporate insolvency resolution process (herein referred to as CIRP). Sections 7 and 9 allow the financial and operational creditor respectively to initiate corporate debtor's CIRP by filing an application with the National Company Law Tribunal (NCLT). A corporate applicant can initiate a corporate debtor's CIRP under Section 10 of the IBC. The incorporation of this right is credited as it gives an opportunity to the debtors to initiate the resolution of the insolvency which benefits both the creditor and the debtor through initiation of recovery of both the company and the debt. It is a boon for the debtors who are resistant in taking the step towards resolution and in turn damaging the credit support of their institution.

INITIATION BY CORPORATE DEBTOR

The concept of self-initiation of insolvency procedure is not a new concept. Section 15 of the Sick Industrial Companies (Special Provisions) Act, 1985 gives the power to the Board of Directors of industrial companies who has become sick to make a reference to BIRF within sixty days from the date of finalisation of the duly audited accounts of the company for the

[2] Company Appeal (AT) (Insolvency) No. 1 & 2 of 2017, Judgment dated 15 May 2017.
[3] Insolvency and Bankruptcy Code, 2016.

financial year at the end of which the company has become a sick industrial company[4] to take measures to revive itself. The procedure of revival under SICA was considered to be lengthy and not fruitful. The liberties were abused, plagued with uncertainties[5] and violated. The scope of an unlimited moratorium was often abused by the promoters who were still in possession of their assets making SICA an ineffective legislation.

According to Insolvency and Bankruptcy Board of India (IBBI), both the creditors as well as the debtors should be given the opportunity to trigger an insolvency resolution. The trigger for each party should be such that it creates an even balance of power for the negotiations in the IRP.[6]

One of the main reasons for inflicting the debtors with the power for initiation is that they are the stakeholders who hold the most information about the current condition of the company. They are aware of the inner dynamics and are the best judge to determine where they actually stand. Since the debtor will always have more information about the enterprise than the creditor, they tend to have the upper-hand in the negotiation.[7] This gives the debtors an opportunity to reduce the information asymmetry that exists between the stakeholders and give the creditors the information most relevant to them. Thus, the debtor can be the management or the majority shareholder, who has access to the degree of information that is required by the Code.[8]

SECTION 10 OF IBC AND ITS INGREDIENTS

Section 10 of the IBC deals with the initiation of insolvency proceedings by a corporate debtor. Section 5(5) delineates a corporate applicant to be a corporate debtor; or a member or partner

[4] Sick Industrial Companies Act, 1985 § 15.
[5] Ankoosh Mehta, *Repeal of Sick Industrial Companies (Special Provisions) Act, 1985*, INDIA CORPORATE LAW, A CYRIL AMARCHAND MANGALDAS BLOG, https://corporate.cyrilamarchandblogs.com/2017/02/repeal-sick-industrial-companies-special-provisions-act-1985/ (Last visited on Feb 18, 2018).
[6] The report of the Bankruptcy Law Reforms Committee Volume I: Rationale and Design, available at http://ibbi.gov.in/BLRCReportVol1_04112015.pdf.

[7] *Id.*
[8] *Id.*

of the corporate debtor who is authorised to make an application for the corporate insolvency resolution process under the constitutional document of the corporate debtor; or an individual who is in charge of managing the operations and resources of the corporate debtor; or a person who has the control and supervision over the financial affairs of the corporate debtor.[9]

The default of 1 lakh rupees or more is a prerequisite for provisions of insolvency and liquidation of corporate persons to be applicable. However, the Central government holds the power to increase this minimum threshold without exceeding 1 crore rupees. This trigger threshold is quite low making it easy for debtors to invoke this provision and turn it around to their benefit. Along with the application, the debtor must include statements of the books of accounts at the time of application as well as the audited balance sheet for the two years prior to the application, and the cash-flow status of the entity during the same period. The Code also requires that these documents are submitted with a "Statement of Truth" document signed by the debtor applicant.[10] The rationale behind the submission of these extensive documents is to reduce the information asymmetry. These documents expose the assets and liability balance of the entity. Apart from this, the debtor has to propose a resolution professional who will be appointed as an interim resolution professional. Within fourteen days of the receipt of the application, the Adjudicating Authority may admit or reject the application. If rejected on the ground of the application being incomplete, the Adjudicating Authority is required to give a notice to the applicant to rectify the defects within seven days from the date of receipt of such notice. Thereafter, the insolvency proceeding will commence from the date of admission of the application. In one of the first cases under Section 10, Shree Rajeshwar Weaving Mills Pvt. Ltd.[11] the NCLT, Mumbai admitted the application of the corporate debtor who was in default in discharging their debt due to the inability to pay the dues of approximately Rs. 16 Crores to the Bank of India. The petitioner filed the list of assets and liabilities, proposed an interim resolution professional and checked off all the obligations as required. Similarly, In M/s. Vedika Nut Craft Private Limited[12] the corporate debtors filed an application as marker factors beyond the control of management had led to a serious financial crisis. The debtors had made earnest efforts to revive the business and gave various opportunities to the creditors in the form

[9] Insolvency and Bankruptcy Code, 2016 § 5(5).
[10] See *supra* note 5.
[11] C.P. No. 15/1 & BP/NCLT/MAH/2017, Order dated 2 March 2017.
[12] C.P. No. (IB)-40(PB)/2017, Order dated 30 June 2017.

of proposals which were not followed through. The tribunal also discussed the guidelines that need to be followed for the initiation of CIRP by a corporate debtor. It was held that apart from the statutory documentary requirements, since, the corporate debtor is initiating the process of insolvency itself it is imperative on the corporate debtor to disclose all the facts in relation to the debts owed to the creditors both financial and operational; securities offered to the creditors and the assets of the corporate debtor. Since the process is self-initiated in so far as the corporate debtor is concerned, all the disclosures must be true and correct and must not be made to scour for any concession it may get in the process, including moratorium, with a view to deny the recovery of bonafide and lawful debt owed to its creditors, including financial and operational.[13] Thereafter, the tribunal keeping in mind that all the statutory requirements have been met and the respondents have failed to any defect warranting the refusal to admit the petition approved the same and declared a moratorium for the purposes of Section 14 of the Code. According to the need of the hour the tribunal proposed that the resolution process should preferably be completed within a period of 100 days for the speedy recovery of the business.

RESTRICTIONS TO FILE

Section 11 of IBC lists out persons who are not entitled to make an application. The list comprises of a corporate debtor who is undergoing an insolvency resolution process; a corporate debtor having completed corporate insolvency resolution process twelve months preceding the date of making of the application; a corporate debtor or a financial creditor who

[13] *Id.*

has violated any of the terms of resolution plan which was approved twelve months before the date of making of an application and a corporate debtor in respect of whom a liquidation order has been made.[14] The underlying principle on which these persons lose their right is based on public policy and their failure to perform their duty timely which resulted in the curtailment of this right.

Apart from the defect in the application and grounds illustrated in Section 11 there are no other restrictions that bar a debtor to file an application. This should mean that once these requirements are fulfilled, NCLT should admit the plea. However, it is noticed that NCLTs are issuing notices to creditors and are listening to their objections regarding the admission of the application. Before the initiation, NCLT is asking the debtors to provide them with reasonable grounds as to why their application should be admitted. This privilege is not extended to an application filed by a financial creditor under Section 7 which was amply illustrated in Innoventive Industries v. ICICI[15], where the Hon'ble National Company Law Appellate Tribunal (NCLAT) held that to suffice the initiation of the process, the only requirement is to fulfil the ingredients so mentioned in Section 7 and beyond that no other factors will be taken into consideration. The rationale behind giving this levy to the creditors to object is to make sure that the debtors do not file an application with any other ulterior motive but that the present situation demands so. In Leo Duct Engineers & Consultants Ltd[16] a petition was filed by the corporate debtor who were unable to liquidate their outstanding liabilities of approximately Rs. 32 Crores towards Canara Bank and Standard Chartered Bank. The bench explicitly held that it is not sufficient to just meet the requirements under Section 10. The Adjudicating Authority has to consider the merits of each case and see beyond what meets the eye, and only after due application of mind, consider the case on its merits.[17] The admission of the said petition would have led to irreparable loss and injury to the financial debtors whose protection is of paramount importance in debt recovery. Therefore, the tribunal rejected the application on the ground that the motive behind for filing the petition was to be dispossessed and not the resolution of debts

[14] Insolvency and Bankruptcy Code, 2016 § 11.
[15] See *supra* note 2.

[16] C.P. No. 1103/I&BP/NCLT/MAH/2017, Order dated 22 June 2017.

[17] *Id.*

or stabilising the business.

PROTECTION FROM FALSE CLAIMS

The Code seeks to provide protection from both fraud and malpractice while initiating resolution proceedings. The aim of the Code is to provide for a better financial future for the stakeholders and that they act honestly while disclosing their assets, liabilities and other obligations. The stakeholders deserve more than just the crumbs of justice and thus various provisions have been laid down to prevent any wrongdoing. Section 65 and 66 of the Code extend protection from fraudulent applications filed by corporate applicants with the intention to defraud the creditors and save themselves from the liabilities so created. The process of improved information symmetry between the creditors and the debtors can be attained only when the debtors are honest in all their disclosures without any false representation or concealment of facts. The electronic submission of the documents with the Information Utility to some extent eliminate this issue, but when clarifications are required and the debtors seem to be uncooperative, the resolution professional can file against the debtor to the adjudicator. The Adjudicator can hold a hearing with the debtor, and issue an order to the debtor to cooperate with the resolution professional. If the resolution professional does not report that the debtor has cooperated with the resolution professional within the specified time, the Adjudicator can close the IRP case, withdraw the moratorium against debt recovery and new cases filed against the entity, ban the debtor from triggering an IRP for a specified period, and issue an order for the debtor to pay all the costs incurred during the IRP.[18]

Section 65 of the Code delineates that if any person initiates the insolvency resolution process or liquidation proceedings fraudulently or with malicious intent for any purpose other than for the resolution of insolvency, or liquidation, as the case may be, the Adjudicating Authority may impose upon such person a penalty which shall not be less than one lakh rupees, but may extend to one crore rupees; or if, any person initiates voluntary liquidation proceedings with the intent

[18] See *supra* note 5.

to defraud any person, the Adjudicating Authority may impose upon such person a penalty which shall not be less than one lakh rupees but may extend to one crore rupees.[19] The intent of filing the application by the debtor in this particular provision is of paramount importance. The very purpose of the Code would stand defeated if debtors are given the levy to file an application with malicious intent. As in M/s. EHLPL Private Limited v. M/s. ICICI Bank Limited[20] the NCLT, New Delhi stated that the provisions of the IBC, 2016 has predominantly been brought into force for the re-organization and insolvency resolution of corporate persons and that too in a time bound manner or the maximization of the value of assets and promote entrepreneurship as well as balancing the interest of all the stakeholders.

The Code fails to provide for a proper guideline which encompasses the grounds to be considered as being done with fraudulent or malicious intent. It is left to the subjective interpretation of the tribunals and how the facts of the case evolve. In Diamond Power Transformers Ltd. v. Indian Overseas Bank & Ors[21], the tribunal admitted the application under Section 10 of the Code despite knowing the fact that the petitioners had given contradictory facts when were before the Debt Recovery Tribunal. The contradiction was regarding the default committed during the payment of the debt due to SICOM. Herein the tribunal held that the mere fact of the existence of the said contradiction that the petitioner had not committed any default in the payment of the debt to SICOM does not suffice the 'intent' required for it to fall under the scope of Section 65. Rejecting the application on this basis would only defile the creditors and the scope of uncovering a stable resolution plan. In Unigreen Global Private Limited[22], the application filed by the corporate debtor was rejected. The financial creditors contended that the debtors had failed to disclose the complete facts before the tribunal in relation to the assets mortgaged or securities furnished. The properties of the entity have been registered in the personal name of the director of the company and caught in legal entanglements which have been purposefully created by the directors to avoid liability. They manipulated the business by directly dealing with the buyers and instituted suits just to get their properties away from the clutches of law. The tribunal in this regard on the basis of the presence

[19] Insolvency and Bankruptcy Code, 2016 § 65.
[20] C.P. No. (IB) – 508(PB)/2017, Order dated 11 December 2017.
[21] C.P.(I.B.) No. 28/10/NCLT/AHM/2017, Order dated 6 June 2017.

[22] C.P. No. IB-39 (PB)/2017, Order dated 08 May 2017.

of incomplete facts dismissed the application under Section 10 and further with a view to discourage others parties to abuse the process of IBC made the debtors liable under Section 65 of the Code and imposed a penalty of Rs. 10, 00,000/-.

Further, one of the major argument brought forth is that the corporate applicant fraudulently initiate insolvency proceedings to take the shield of the moratorium provided under Section 14 of the Code. A moratorium is a period a wherein no judicial proceedings for recovery, enforcement of security interest, sale or transfer of assets, or termination of essential contracts can be instituted or continued against the Corporate Debtor.[23] The period of moratorium lasts as long as the Corporate Insolvency Resolution Process. If the plan is approved or the company is to be liquidated, moratorium ceases. Even though during this period no proceedings will stay against the debtor, it should be duly noted that the ultimate fate of the company still institutes with the creditors. It is up to the creditors to either approve the liquidation plan or push the company into liquidation. It is not reasonable to assume that a debtor will file a malicious application running the risk of the company's liquidation. The protection of mere 14 days in no possibility can out run the risk of a failed resolution plan preceding winding up of the company. It is gratuitous to assume that the power granted to corporate applicants is expansive with loopholes. Therefore, the fact that the debtors sought moratorium against recovery proceedings does not suffice the ground of having malicious or fraudulent intent considering the fact that the very purpose of a moratorium is to provide for a calm period.

The Code has taken inspiration from the UK Insolvency Act, 1986. Section 213 and 214 of the UK Insolvency Act, 1986 illustrate fraudulent and wrongful trading respectively. Fraudulent trading occurs where persons who are engaged in the carrying on of the business do so with an intent to defraud or any fraudulent purposes[24] while wrongful trading is when the director of the company could foresee that the company could not under ordinary circumstances avoid going into insolvent liquidation but does not act on it. For fraudulent trading the business should be carried on with an intent to defraud and the knowledge of the same should be proved. A director is an individual lawfully appointed to the Board of Directors of a company which is

[23]Kunal Godhwani, *India: Moratorium under Insolvency and Bankruptcy Code, 2016- Impact on pending proceedings*, http://www.mondaq.com/india/x/644310/Insolvency+Bankruptcy/Moratorium+Under+Insolvency+And+Bankruptcy+Code+2016+Impact+On+Pending+Proceeding (Last visited on Feb 20, 2018).

[24] *Re L Todd (Swanscombe) Ltd* (1990) BCLC 454.

duly constituted to direct, control and supervise the affairs of a company.[25] Under Section 66(2) of the Code, a director or a partner of a corporate debtor can be made personally liable to contribute to the assets of the debtor if before the insolvency commencement date, such director or partner knew or ought to have known that the there was no reasonable prospect of avoiding the commencement of a corporate insolvency resolution process in respect of such corporate debtor.[26] Exercising due diligence is one of the key functions that a director needs to perform. Herein, if the director did not exercise due diligence in minimizing the potential loss to the creditors in accordance with his duties, he will be held personally liable for fraudulent or wrongful trading.

CONCLUSION

Section 10 has provided for an important platform to the debtors to resolve their issues when the creditors and other stake holders don't seem to take any interest in the same. It is quite evident that the foremost objective of the Code has been to protect the interest of the creditors. This objective even though applied in good faith is not immune to certain shortcomings. To balance these drawbacks, it is imminent to provide debtors with a certain right to themselves. This will not only create a system of checks and balances but also establish a sense of equality. Further, when the Code moves away from its objective by giving debtors privileges, it has also provided for barriers like Section 65 and 66 for protection. These protections should not be taken nonchalantly. Therefore, the future of the insolvency resolution in India will evolve based on how these provisions are invoked and the tribunal's interpretation of the same.

[25] LVV IYER, GUIDE TO COMPANY DIRECTORS 3 (LexisNexis 4th edn. 2016).
[26] Insolvency and Bankruptcy Code, 2016 § 66(2).